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Supreme Court, U.S.

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In the Supreme Court of the United States

OCTOBER TERM, 1994

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ERICH E. AND HELEN B. SCHLEIER

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether back pay and liquidated damages received in settlement of litigation under the Age Discrimination in Employment Act of 1967 are excluded from gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 68a-69a) is unpublished, but the decision is noted at 26 F.3d 1119 (Table). The opinion of the Tax Court (Pet. App. 64a-65a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 21, 1994. The petition for a writ of certiorari was filed on September 19, 1994, and was granted on

November 14, 1994. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

1. Section 61(a) of the Internal Revenue Code, 26 U.S.C. 61(a), provides in relevant part:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived.

2. Section 104(a) of the Internal Revenue Code, 26 U.S.C. 104(a) (1988 & Supp. V 1993), provides in relevant part:

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;

3. Section 104-1(c) of the Treasury Regulations, 26 C.F.R. 1.104-1(c), provides:

Section 104(a)(2) [of the Internal Revenue Code] excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon

tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

STATEMENT

1. Respondent Erich E. Schleier is a former employee of United Airlines, Inc.¹ Pursuant to an established policy of United Airlines, respondent's employment was terminated when he reached the age of sixty (Tax Ct. Pet. 2-3). Respondent thereafter filed a complaint in federal district court alleging that his termination violated the Age Discrimination in Employment Act of 1967 (ADEA), which (with exceptions not relevant here) makes it "unlawful for an employer * * * to discharge any individual * * * because of such individual's age" (29 U.S.C. 623(a)(1)). The remedies for an unlawful discharge under the ADEA include reinstatement, back pay, injunctive and declaratory relief and attorneys fees. See 29 U.S.C. 626(b); 29 U.S.C. 216(b), 217. The ADEA also authorizes an additional award of "liquidated damages" in an amount equal to the backpay award "in cases of willful violations" of that Act. 29 U.S.C. 626(b).

Respondent's complaint was consolidated within a class action suit against United Airlines. On June 30, 1986, the class action was settled under an agreement providing for monetary payments to the class members. One half of the settlement payment was attributed to "back pay"; the other half of the payment was attributed to "liquidated damages." As a result of the settlement, respondent received "back

¹ Respondent's wife Helen is a party to this case solely because the couple filed a joint return during the year in question.

pay" of \$72,814.50 and "liquidated damages" in the same amount (Tax Ct. Pet. 4-5).

Respondent reported the "back pay" as income on his 1986 tax return. He did not, however, report the "liquidated damages" that he received under the settlement. The Commissioner of Internal Revenue issued a notice of deficiency to respondent, asserting that the liquidated damages were improperly excluded from his income, resulting in a deficiency of \$35,918.50 in respondent's income tax for 1986 (Tax Ct. Pet. 2).

2. Respondent commenced this case in Tax Court to obtain a redetermination of the asserted deficiency. The petition alleged that the liquidated damages portion of the settlement payment was properly excluded from gross income under Section 104(a)(2) of the Internal Revenue Code, which provides that "gross income does not include" (26 U.S.C. 104(a)(2))

the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

The petition further alleged that the "back pay" portion of the settlement payment, which had been reported as income on respondent's 1986 return, was also excludable from gross income under Section 104(a)(2). Respondent therefore sought a determination of overpayment (as authorized by 26 U.S.C. 6512(b)).

a. Proceedings on respondent's case were deferred pending the Tax Court's disposition of the lead case relating to the United Airlines class action settlement, *Downey v. Commissioner*, 97 T.C. 150 (1991), supplemental opinion, 100 T.C. 634 (1993), rev'd, 33 F.3d 836 (7th Cir. 1994), petition for cert. pending, No. 94-999 (filed Dec. 5, 1994).

In its original opinion in *Downey*, the Tax Court (in a reviewed opinion with six judges dissenting in part) held that back pay and liquidated damages received under the ADEA are excludable from gross income under Section 104(a)(2). With respect to back pay, the Tax Court expressly adopted (Pet. App. 21a-24a) the reasoning of *Rickel v. Commissioner*, 900 F.2d 655 (3d Cir. 1990), and *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990), which held that backpay awards under the ADEA are excludable from gross income because (i) an ADEA suit alleges a violation of duty that arises by operation of a statute and not by virtue of a contract and (ii) statutes addressing discrimination in the workplace had been characterized by other courts as involving personal injury. 900 F.2d at 662-663; 912 F.2d at 149-150.

With respect to liquidated damages, the Tax Court in *Downey* rejected the Commissioner's contention that ADEA liquidated damages—like punitive damages—are paid because of the employer's willful misconduct, rather than "on account of personal injuries" (26 U.S.C. 104(a)(2)) to the employee, and are therefore not excludable from gross income under the plain language of the statute. Pet. App. 26a. See *Commissioner v. Miller*, 914 F.2d 586, 589-591 (4th Cir. 1990). The Tax Court held that, while ADEA liquidated damages serve a punitive purpose, these damages, when viewed from the victim's perspective, represent compensation for nonpecuniary losses. Pet. App. 26a-29a.

b. The Tax Court withheld entry of its final decision in *Downey* pending this Court's decision in *United States v. Burke*, 112 S. Ct. 1867 (1992). In *Burke*, this Court held that backpay awards received in settlement of litigation under the pre-1991 version

of Title VII of the Civil Rights Act of 1964 are not excludable from gross income under Section 104(a)(2). In reaching that conclusion, the Court emphasized that a statute “whose sole remedial focus is the award of backwages” (112 S. Ct. at 1874) does not represent a tort-like remedy of a personal injury but instead represents redress for “legal injuries of an economic character” (*id.* at 1873, quoting *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975)). The Court concluded that a backpay remedy that redresses an economic injury is “not excludable from gross income as ‘damages received . . . on account of personal injuries’ under § 104(a)(2).” 112 S. Ct. at 1874.

After this Court issued its decision in *Burke*, the Tax Court granted the Commissioner’s motion for reconsideration of the *Downey* decision. In a supplemental opinion in *Downey* (with several separate opinions), the Tax Court emphasized that one of the hallmarks of tort liability is the availability of a broad range of damages to compensate the victim, as well as punitive damages when the defendant’s conduct was intentional or reckless. Pet. App. 42a. The Tax Court observed that in contrast to the pre-1991 version of Title VII involved in *Burke* (which limited the available remedies to back pay and equitable relief, see 112 S. Ct. at 1872-1874 & nn.8, 12), the ADEA provides “a range of remedies, including both unpaid wages and ‘liquidated damages.’” Pet. App. 44a. The Tax Court concluded that the ADEA “evidences a tort-like conception of injury and remedy” because liquidated damages under the ADEA compensate the victim of age discrimination for non-pecuniary losses and also serve a deterrent or punitive purpose. *Id.* at 45a. The Tax Court therefore reaffirmed its prior holding in *Downey* that all dam-

ages received in ADEA litigation are excludable from gross income under Section 104(a)(2). Pet. App. 45a.

On July 7, 1993, the Tax Court entered an order in the present case granting respondent’s motion for summary judgment based on the court’s ruling in *Downey*. Pet. App. 64a-65a.

3. The Commissioner appealed from the Tax Court’s ruling in this case and in *Downey*. While these appeals were pending, the Fifth Circuit endorsed and adopted the Tax Court’s decision in *Downey* in the course of addressing a damages issue in private ADEA litigation in which the United States was not a party and did not participate. *Purcell v. Seguin State Bank & Trust Co.*, 999 F.2d 950, 961 (1993).² The court in *Purcell* agreed with the Tax Court’s reasoning that “ADEA claims are tort-like and that an entire ADEA award is non-taxable.” *Ibid.*

a. Because the Fifth Circuit had recently endorsed the Tax Court’s *Downey* decision in *Purcell*, the Commissioner filed a suggestion that the appeal in respondent’s case be heard *en banc*. The Fifth Circuit rejected that suggestion. Pet. App. 67a. The three-judge panel assigned to this case then entered a decision in favor of respondent solely on the authority of *Purcell*. Pet. App. 68a-69a.

b. On the Commissioner’s appeal from the *Downey* decision, the Seventh Circuit reversed the Tax

² In *Purcell*, the court concluded that an ADEA backpay award should not be increased to take account of the employee’s income tax liabilities because, under the Tax Court’s ruling in *Downey*, the ADEA award would not be subject to tax under Section 104(a)(2) of the Code. See 999 F.2d at 961.

Court, holding that ADEA backpay and liquidated damages awards are *not* excluded from income under Section 104(a)(2). *Downey v. Commissioner*, 33 F.3d 836, petition for cert. pending, No. 94-999 (filed Dec. 5, 1994). The Seventh Circuit reasoned that (33 F.3d at 839):

Burke stands for the proposition that a federal anti-discrimination statute must provide compensatory damages for intangible elements of personal injury (such as pain and suffering, emotional distress, or personal humiliation) to constitute a tort-type personal injury and receive tax-exempt treatment under § 104(a)(2).

The court noted that the only damages remedies under the ADEA are back pay and liquidated damages and that neither of these remedies "compensate for the intangible elements of a personal injury." 33 F.3d at 840. Because the limited remedies available under the ADEA thus lack "an essential element of a tort-type claim," the Seventh Circuit concluded that, under this Court's analysis in *Burke*, the damages awarded under the statute "cannot be excluded from taxation under § 104(a)(2)." 33 F.3d at 840.

c. In an appeal involving a different party to the United Airlines settlement, the Ninth Circuit affirmed a Tax Court decision based upon *Downey*. *Schmitz v. Commissioner*, 34 F.3d 790 (1994), petition for cert. pending, No. 94-944 (filed Nov. 23, 1994). In *Schmitz*, the Ninth Circuit agreed with the Tax Court that the ADEA represents a "tort-like" cause of action, reasoning that the "ADEA's liquidated damages provision, as well as its provision for jury trials, distinguishes ADEA from the statute discussed in *Burke*." 34 F.3d at 793. The court of appeals con-

cluded that ADEA recoveries are therefore excluded from tax under Section 104(a)(2).

In *Schmitz*, the Ninth Circuit also rejected the Commissioner's additional contention that, if ADEA represents a "tort-type" recovery for a personal injury, the liquidated damages component of that recovery would be subject to tax in any event because it does not represent an award "on account of personal injuries" (26 U.S.C. 104(a)(2)) but is instead a penalty "on account of" the employer's willful misconduct. 34 F.3d at 794-796. The court stated that liquidated damages under the ADEA are compensatory rather than punitive—because they are designed to "compensate victims for damages which are too obscure and difficult to prove" (*id.* at 794)—and are therefore excluded from tax under Section 104(a)(2).

SUMMARY OF ARGUMENT

Section 104(a)(2) of the Internal Revenue Code provides that gross income does not include "the amount of any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." In *United States v. Burke*, 112 S. Ct. 1867 (1992), this Court held that Section 104(a)(2) applies only when the underlying cause of action that led to the taxpayer's recovery provides compensation for the "personal," as well as "economic," components of the taxpayer's injury. The Court concluded that a cause of action that does not compensate for the traditional harms associated with personal injuries—such as pain and suffering, emotional distress, and harm to reputation—does not yield "damages * * * on account of personal injuries" within the exclusion from gross income provided by Section 104(a)(2).

The interpretation of Section 104(a)(2) adopted by the Court in *United States v. Burke* governs, and disposes of, the issues in this case. Even though discrimination based upon age can effect "personal" injuries, back pay awarded under the ADEA provides compensation only for the economic, and not the personal, components of that injury. The ADEA provides no remedy for the traditional harms associated with a "personal injury," such as pain and suffering, emotional distress and harm to reputation. The award of back pay under the ADEA thus does not compensate for "damages * * * on account of personal injuries" under this Court's decision in *Burke*.

The availability of liquidated damages under the ADEA does not alter this result for two reasons. First, liquidated damages under the ADEA do not compensate the employee for the traditional elements of personal injury, such as pain and suffering and emotional distress. Liquidated damages under the ADEA are an enforcement mechanism to deter "willful violations" of the Act; they are not available as, and do not provide, compensation for the personal elements of the employee's injury. The availability of liquidated damages under the ADEA thus does not convert the backpay award into "damages * * * on account of personal injuries." Second, liquidated damages cannot themselves be excluded from gross income under Section 104(a)(2) because such damages are awarded "on account of" the employer's willful misconduct, not "on account of personal injuries." Liquidated damages, like punitive damages in an ordinary tort suit, are therefore not excluded from gross income under the plain language of the statute.

ARGUMENT

BACK PAY AND LIQUIDATED DAMAGES RECEIVED IN SETTLEMENT OF LITIGATION UNDER THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967 ARE NOT EXCLUDED FROM GROSS INCOME UNDER SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE AS "DAMAGES RECEIVED * * * ON ACCOUNT OF PERSONAL INJURIES OR SICKNESS"

The first step in calculating taxable income under the Internal Revenue Code is to determine the taxpayer's "gross income." Section 61(a) provides that, subject to specific exclusions set forth elsewhere in the Code, "gross income means all income from whatever source derived." This sweeping statutory definition broadly reflects the Legislature's intent to exert the full measure of its taxing power. *United States v. Burke*, 112 S. Ct. 1867, 1870 (1992). Any funds or other "accessions to wealth" (*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-431 (1955)) received by a taxpayer represent "gross income" unless the taxpayer establishes that the income falls within one of the specific exclusions created by other sections of the Code.

It is not disputed that the payment received by respondent in settlement of his age-discrimination suit under the Age Discrimination in Employment Act of 1967 (ADEA) represents an "accession to wealth" that constitutes "gross income" within the broad scope of Section 61(a). The question presented in this case is whether that payment is excluded from "gross income" by Section 104(a)(2) of the Code, which provides that "gross income does not include * * * the amount of any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." 26 U.S.C. 104(a)(2). As an

exclusion from gross income, Section 104(a)(2) is to be narrowly construed. *United States v. Centennial Savings Bank*, 499 U.S. 573, 583-584 (1991). See also *United States v. Burke*, 112 S. Ct. at 1876 (Scalia, J., concurring); *id.* at 1878 (Souter, J., concurring).

A. Section 104(a)(2) Authorizes An Exclusion From Income Only For Damages Received On Account Of Personal Injuries Or Sickness

The statutory phrase—"damages received * * * on account of personal injuries"—is not explained in the text of the statute or in its legislative history. *United States v. Burke*, 112 S. Ct. at 1870. As this Court has noted, the term "personal injuries" is susceptible of more than one interpretation. See *id.* at 1871-1872 n.6; *id.* at 1875 (Scalia, J., concurring).³ In *United States v. Burke*, however, the

³ The lineage of Section 104(a)(2) is as ancient as the modern income tax. The statute was first enacted as Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066 (1919). The Internal Revenue Service originally interpreted the statute to apply only to damages recovered in connection with physical injuries. See Sol. Mem. 1384, 2 C.B. 71 (1920); Sol. Op. 132, I-1 C.B. 92, 93 (1922). In 1972, however, the Service acquiesced in the Tax Court's decision in *Seay v. Commissioner*, 58 T.C. 32 (1972), which held that damages from nonphysical personal injuries are also excluded from gross income under the statute. See 1972-2 C.B. 3. See also Rev. Rul. 74-77, 1974-1 C.B. 33 (compensation for alienation of affections excluded from gross income under the statute).

The origin of Section 104(a)(2), and the lengthy history of its administration, are discussed in detail in the government's brief in *United States v. Burke*, No. 91-42, at 10-15. In *Burke*, the Court considered this history and concluded that the statutory term "'personal injuries' encompasses, in accord with common judicial parlance and conceptions, * * *

Court reviewed the lengthy history of the statute and its administration and adopted an interpretation of Section 104(a)(2) that governs, and disposes of, the issues presented in this case.

1. In *Burke*, the Court held that an award of back pay under the pre-1991 version of Title VII of the Civil Rights Act did not constitute "damages received * * * on account of personal injuries or sickness." The Court did not doubt that discrimination in violation of Title VII effects a "personal" injury (112 S. Ct. at 1873), for such discrimination is "an invidious practice that causes grave harm to its victims" (*id.* at 1872). The Court noted, however, that the monetary remedy then available under Title VII was limited to back pay (*id.* at 1874 & n.12) and that the recovery obtained by the taxpayer in *Burke* thus focussed exclusively on "legal injuries of an economic character." *Id.* at 1873, quoting *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975). Since Section 104(a)(2) provides an exclusion only for damages awarded "on account of personal injuries," and since the taxpayer in *Burke* had received no compensation for the "traditional harms associated with personal injury, such as pain and suffering, emotional distress, [and] harm to reputation" (*id.* at 1873), the Court held that Section 104(a)(2) was not applicable.

The Court thus concluded in *Burke* that Section 104(a)(2) applies only when the underlying cause of action that led to the taxpayer's recovery provides compensation for the "personal," as well as "economic," components of the taxpayer's injury. 112

nonphysical injuries to the individual, such as those affecting emotions, reputation, or character, as well [as physical injuries]." 112 S. Ct. at 1871 n.6.

S. Ct. at 1874. A cause of action that does not compensate for the traditional harms associated with personal injuries—"such as pain and suffering, emotional distress, [and] harm to reputation"—does not yield "damages * * * on account of personal injuries" within the exclusion from gross income provided by Section 104(a)(2).⁴

2. The Court drew support for its interpretation both from the language of the statute and from the administrative practice under it. The Internal Revenue Service has long interpreted Section 104(a)(2) to apply only to recoveries based upon "tort or tort type" claims that compensate for personal, as well as economic, injuries. See 26 C.F.R. 1.104-1(c); Rev. Rul. 72-341, 1972-2 C.B. 32 (back pay under pre-1991 version of Title VII not excluded from income); Rev. Rul. 72-268, 1972-1 C.B. 313 (overtime and minimum wages awarded under Fair Labor Standards Act not excluded from income).⁵

⁴ The availability of compensatory damages for intangible elements of personal injury such as pain and suffering and emotional distress is an essential characteristic of a personal injury tort action. See *Vicksburg & Meridian R.R. v. Putnam*, 118 U.S. 545, 554 (1886); 3 L. Frumer & M. Friedman, *Personal Injury* § 3.01, at 94 (1991); 2 S. Speiser, C. Krause & A. Gans, *The American Law of Torts* § 8:18, at 552 (1985). Awards for pain and suffering are estimated to account for 72% of damages in personal injury litigation. *Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523, 552 n.35 (1983). See also D. Dobbs, *Remedies* 530 (1973) ("emotional distress is a strong element in the dignitary tort cases and accounts for a substantial portion of the damages award").

⁵ In 1960, the Internal Revenue Service adopted regulations that "linked identification of a personal injury for purposes of § 104(a)(2) to traditional tort principles" (*United States*

The Court noted in *Burke* that a claim based upon "a 'dignitary' or nonphysical tort" permits recovery "not only [of] any actual pecuniary loss (e.g., loss of business or customers), but for 'impairment of reputation and standing in the community, personal humiliation, and mental anguish and suffering.'" 112 S. Ct. at 1871-1872, quoting *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974). See also D. Dobbs, *Remedies* 509 (1973) (with dignitary torts, "though economic or physical loss may be associated with the injury, the primary or usual concern is not economic at all, but vindication of an intangible right"). The Court concluded that a legal claim that provides no compensation for these intangible, personal elements of injury is not a "tort or tort type" claim within the meaning of the regulation (112 S. Ct. at 1873) and that any resulting award based on such a claim does not represent damages "on account of personal injuries" within the meaning of the statute (*id.* at 1873-1874).⁶

v. Burke, 112 S. Ct. at 1870) by providing (26 C.F.R. 1.104-1(c)):

The term "damages received (whether by suit or agreement)" means an amount received * * * through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

⁶ Justice Souter's concurring opinion reached the same conclusion by a different route. Justice Souter identified the dispositive question in *Burke* to be whether the underlying action "was one 'based upon tort or tort type rights.'" 26 C.F.R. § 1.104-1(c) (1991)." 112 S. Ct. at 1877. He noted that the limitation of recovery to back pay under the pre-1991 version of Title VII reflected a "quintessentially * * * contractual measure of damages" (*ibid.*) and thus departed from the ordinary model of tort relief. Justice Souter con-

The interpretation of Section 104(a)(2) adopted by the Court in *Burke* is supported by the language of the statute and is consistent with the administrative practice. The Court's interpretation has the further virtue of providing an administrable rule. Following the decision in *Burke*, the Internal Revenue Service concluded that recoveries under statutory schemes (such as the post-1991 provisions of Title VII) that provide compensation for the "traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, [and] other consequential damages" (112 S. Ct. at 1873), are excluded from income by Section 104(a)(2). See Rev. Rul. 93-88, 1993-2 C.B. 61.⁷

cluded that "the outcome in this case follows from the default rule of statutory interpretation that exclusions from income must be narrowly construed" (*id.* at 1878, citing *United States v. Centennial Savings Bank*, 499 U.S. at 583; *Commissioner v. Jacobson*, 336 U.S. 28, 49 (1949)). Since "an accession to wealth is not to be held excluded from income unless some provision of the Internal Revenue Code clearly so entails," and since in *Burke* there was "no clear application of 26 U.S.C. § 104(a)(2), as interpreted by the Treasury Regulation," Justice Souter concluded that the back pay received by the taxpayer in that case was not excluded from income. 112 S. Ct. at 1878.

⁷ As the Court observed in *United States v. Burke*, 112 S. Ct. at 1874 n.12, the post-1991 provisions of Title VII provide for a broad range of compensatory damages for intangible elements of injury in disparate treatment cases. Following *Burke*, the Service concluded that recoveries in post-1991 Title VII disparate treatment cases—as well as compensatory damages received under 42 U.S.C. 1981 (Supp. IV 1992) and under the Americans with Disabilities Act—are excluded from gross income under Section 104(a)(2). Rev. Rul. 93-88, 1993-2 C.B. 61, 63. The 1991 amendments to Title VII did not, however, alter the remedies available in

By contrast, statutory remedies that do not compensate for the "traditional harms associated with personal injury" are not excluded from income under the statute. *Id.* at 62-63.

L. Back Pay And Liquidated Damages Awarded Under The ADEA Do Not Represent Damages Received On Account Of Personal Injuries

The remedies for an unlawful discharge under the ADEA include reinstatement, back pay, injunctive and declaratory relief and attorneys fees. See 29 U.S.C. 626(b); 29 U.S.C. 216(b), 217. The ADEA also authorizes an additional award of "liquidated damages" in an amount equal to the backpay award "in cases of willful violations" of that Act. 29 U.S.C. 626(b). The back pay and liquidated damages received by respondent under the ADEA do not compensate for the "traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, [and] consequential damages" (*United States v. Burke*, 112 S. Ct. at 1873). ADEA back pay and liquidated damages compensate for economic losses but provide no compensation for the personal component of the victim's injuries. They therefore do not represent damages received "on account of personal injuries" and are not excluded from income under Section 104(a)(2).

1. Applying this Court's decision in *Burke*, the Seventh Circuit properly concluded in *Downey v. Commissioner*, 33 F.3d at 839, that back pay and

disparate impact cases from those available in *Burke*. The Service accordingly ruled in Revenue Ruling 93-88 that back pay received in disparate impact cases is not excluded from gross income. 1993-2 C.B. at 63.

liquidated damages received under the ADEA are not excludable from gross income under Section 104 (a)(2). The remedial scheme of the ADEA, like the remedial scheme of pre-1991 Title VII, focusses on the economic loss, rather than the personal injury, of the employee. See *Castle v. Sangamo Weston, Inc.*, 837 F.2d 1550, 1561 (11th Cir. 1988); *Kolb v. Goldring, Inc.*, 694 F.2d 869, 872 (1st Cir. 1982).⁸ The ADEA authorizes back pay, reinstatement (as equitable relief), front pay in lieu of reinstatement, and liquidated damages for willful violations. See *Hansard v. Pepsi-Cola Metropolitan Bottling Co.*, 865 F.2d 1461, 1469 & n.3 (5th Cir.), cert. denied, 493 U.S. 842 (1989).⁹ The ADEA does not, however, provide compensation for "traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, or other consequential damages" (*United States v. Burke*, 112 S. Ct. at 1873). See, e.g., *Haskell v. Kaman Corp.*, 743 F.2d 113, 120-121 & n.2 (2d Cir. 1984); *Kolb v. Goldring, Inc.*, 694 F.2d at 872. Indeed, evidence of these intangible elements of personal injury is not admissible in

⁸ The remedial provisions of the ADEA were modeled on, but are not identical to, the remedial provisions of the Fair Labor Standards Act. *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 125 (1985). See also *Lorillard v. Pons*, 434 U.S. 575 (1978); page 22, *infra*.

Under the ADEA, "[p]ain and suffering form no part of the damages." *Kolb v. Goldring, Inc.*, 694 F.2d at 872. "Unlike the tort plaintiff, the plaintiff suing under the ADEA may recover only 'those pecuniary benefits connected to the job relation' and '[f]rom these must be subtracted post-termination economic benefits.'" *Ibid*.

⁹ Front pay was also available under the pre-1991 version of Title VII that was involved in *United States v. Burke*. See 112 S. Ct. at 1873 n.9.

ADEA litigation. *Guthrie v. J.C. Penney Co.*, 803 F.2d 202, 208 (5th Cir. 1986); *Haskell v. Kaman Corp.*, 743 F.2d at 121; *Hill v. Spiegel, Inc.*, 708 F.2d 233, 236 (6th Cir. 1983); *Pfeiffer v. Essex Wire Corp.*, 682 F.2d 684, 688 (7th Cir.), cert. denied, 459 U.S. 1039 (1982).

The only difference between the remedial scheme provided by the pre-1991 version of Title VII involved in *Burke* and the remedial scheme provided by the ADEA is that victims of age discrimination may recover "liquidated damages" equal to the back-pay award under the ADEA when—but only when—the employer has engaged in "willful" violations of the statute (29 U.S.C. 626(b)).¹⁰ Liquidated damages do not compensate for intangible, personal injuries of the employee. Instead, liquidated damages may be awarded *only* in cases where the employee has suffered economic loss from an employer's willful age discrimination. The amount of liquidated damages awarded for "willful violations" of the ADEA (29 U.S.C. 626(b)) is set, by statute, at an amount "equal" to the backpay award (29 U.S.C. 216(b)). When an employee obtains only declaratory or equitable relief and does not recover back pay, or when the employer's violation was not willful, liquidated damages may not be awarded under the ADEA even though the employee suffers a "per-

¹⁰ Federal employees may not recover liquidated damages under the ADEA. 29 U.S.C. 633a; *Smith v. OPM*, 778 F.2d 258, 263 (5th Cir. 1985), cert. denied, 476 U.S. 1105 (1986). The remedies provided to a federal employee under the ADEA are thus identical to the remedies provided by the pre-1991 version of Title VII. Back pay received by federal employees for age discrimination is therefore not excludable from gross income under the precise holding of *United States v. Burke*.

sonal" (as well as "economic") injury from the discrimination (*United States v. Burke*, 112 S. Ct. at 1873). See *Kossman v. Calumet County*, 849 F.2d 1027, 1029-1030 (7th Cir. 1988); *Fariss v. Lynchburg Foundry*, 769 F.2d 958, 967 (4th Cir. 1985). Moreover, when an award of liquidated damages is available under the ADEA, its amount has no relationship to the "personal injuries" endured by the victim of discrimination. As this Court concluded in *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 125-126 (1985), ADEA liquidated damages, which are available only for "willful violations" of the Act, are not compensatory; they are "punitive in nature" and function as an enforcement mechanism to deter intentionally unlawful conduct.

2. The Tax Court thus erred in this case in concluding that liquidated damages under the ADEA are compensatory and represent "only a substitute for difficult to measure personal injuries resulting from discriminatory employment" (Pet. App. 21a). In reaching that conclusion, the Tax Court attempted to distinguish (*id.* at 27a) this Court's conclusion in *Trans World Airlines* that ADEA liquidated damages are "punitive in nature" (469 U.S. at 125). The Tax Court reasoned that "the ADEA was modeled in part" on the Fair Labor Standards Act of 1938 (Pet. App. 28a) and that, under the FLSA, this Court held in *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 707 (1945), and *Overnight Motor Transportation Co. v. Missel*, 316 U.S. 572, 583-584 (1942), that FLSA liquidated damages represented compensation for "damages too obscure and difficult of proof" (Pet. App. 29a). In *Schmitz v. Commissioner*, the Ninth Circuit adopted and applied the

same reasoning as the Tax Court, relying on *Brooklyn Savings Bank* and *Overnight Motor Transportation* to conclude that ADEA liquidated damages are not "solely punitive in nature" but are awarded "to compensate victims for damages which are too obscure and difficult to prove" (34 F.3d at 794).¹¹

The Tax Court and the Ninth Circuit fundamentally erred in relying on *Brooklyn Savings Bank* and *Overnight Motor Transportation*. Prior to 1947, liquidated damages were awarded automatically under the FLSA as additional compensation to every employee whose employer failed to pay the minimum

¹¹ The Ninth Circuit advanced one other reason in support of its conclusion that ADEA recoveries are excluded from tax under Section 104(a)(2). The court noted that, unlike the pre-1991 version of Title VII, jury trials are available under the ADEA. The court of appeals suggested that this fact "distinguishes ADEA from the statute discussed in *Burke*" (34 F.3d at 793). It is true that ADEA litigants are entitled to jury trials (*Lorillard v. Pons*, 434 U.S. 575 (1978)) and that, in *Burke*, this Court noted that jury trials were not available under the pre-1991 version of Title VII. See 112 S. Ct. at 1872. But, while the lack of a right to a jury trial may indicate that the remedy is not "tort type" in nature (see *id.* at 1873), the availability of a jury trial does not indicate that the right is "tort type." At common law, jury trials were available for contract, as well as tort, claims. Moreover, "liquidated damages" are not a traditional tort remedy; instead, they are an ordinary remedy for breach of contract. See *Rex Trailer Co. v. United States*, 350 U.S. 148, 151 (1956); *Restatement (Second) of the Law of Contracts* § 356 (1981).

In *Burke*, the Court held that the dispositive question under Section 104(a)(2) is whether the legal right compensates for the personal, as well as economic, components of the taxpayer's injury. The parties' constitutional or statutory entitlement to a jury trial has only a remote relationship to that inquiry.

wage. *Overnight Motor Transportation Co. v. Missel*, 316 U.S. at 581-584. Under the pre-1947 provisions of the FLSA, liquidated damages in an amount equal to unpaid minimum wages were awarded without any showing that the employer had "willfully," or in bad faith, violated that Act. *Ibid.* It was in that statutory context that this Court stated—in 1945 in *Brooklyn Savings Bank* and in 1942 in *Overnight Motor Transportation*—that FLSA liquidated damages were "not penal in nature but constitute[d] compensation for the retention of a workman's pay which might result in damages too obscure and difficult of proof for estimate other than by liquidated damages." 324 U.S. at 707. See 316 U.S. at 583-584.

The FLSA was amended in 1947, however, to limit the availability of liquidated damages under that Act in situations where the employer had acted "in good faith" and with "reasonable grounds for believing that his act or omission was not a violation" of the Act. 29 U.S.C. 260. See Act of May 14, 1947, ch. 52, § 11, 61 Stat. 89.¹² When the ADEA was enacted

¹² As the Court explained in *Trans World Airlines, Inc. v. Thurston*, 469 U.S. at 128 n.22:

The Court interpreted the FLSA, as originally enacted, as allowing the recovery of liquidated damages any time that there was a violation of the Act. See *Overnight Motor Transportation Co. v. Missel*, 316 U.S. 572 (1942). In response to its dissatisfaction with that harsh interpretation of the provision, Congress enacted the Portal-to-Portal Act of 1947. See *Lorillard v. Pons*, 434 U.S. 575, 581-582, n.8 (1978). Section 11 of the PPA, 29 U.S.C. § 260, provides the employer with a defense to a mandatory award of liquidated damages when it can show good faith and reasonable grounds for believing it was not in violation of the FLSA.

in 1967, and "modeled in part" on the then-existing provisions of the FLSA (Pet. App. 28a), the availability of liquidated damages was further expressly limited to those situations where the employer had "willfully" violated the ADEA. 29 U.S.C. 626(b). It was in this context that this Court correctly concluded in 1985 in *Trans World Airlines, Inc. v. Thurston* that ADEA liquidated damages are "punitive in nature" (469 U.S. at 125) and are designed to "furnish an effective deterrent to willful violations" of that Act. *Ibid.*, quoting 113 Cong. Rec. 7076 (1967) (Sen. Javits). Although mandatory liquidated damages available to every injured party serve a compensatory function, liquidated damages available only for "willful violations" of the Act are solely "punitive in nature." They "are not intended to compensate the injured party, but rather to punish the [party] whose wrongful action was intentional or malicious, and to deter him and others from similar extreme conduct" (*City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 266 (1981)).¹³

Indeed, in *Trans World Airlines*, this Court specifically discussed and distinguished its decisions under the different statutory text involved in *Brooklyn Savings Bank* and *Overnight Motor Transportation*. The Court noted that the "good faith" defense to liquidated damages under the 1947 amendment to the FLSA was adopted by Congress in "dissatisfaction" with the Court's earlier conclusion that such damages

¹³ This Court stated in *International Brotherhood of Electric Workers v. Foust*, 442 U.S. 42, 48 (1979) (internal quotation marks omitted), that "[p]unitive damages are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence."

were automatically available as additional compensation under the FLSA. 469 U.S. at 128 n.22. See note 12, *supra*. After *Brooklyn Savings Bank* and *Overnight Motor Transportation* were decided, Congress concluded that liquidated damages under the ADEA are to be available solely as a punitive measure to deter "willful violations" of that Act, rather than as a form of legal compensation to employees who may incur intangible damages that are too obscure and difficult of proof. See 469 U.S. at 125, 128 n.21. The Tax Court therefore erred (i) in relying on *Brooklyn Savings Bank* and *Overnight Motor Transportation*—which described the compensatory nature of *mandatory* liquidated damages provisions—and (ii) in failing to recognize that those very decisions were distinguished by this Court in *Trans World Airlines, Inc. v. Thurston*, when the Court held that liquidated damages for "willful violations" of the ADEA are not compensatory but "punitive in nature." 469 U.S. at 125, 128 n.22.¹⁴

Because neither back pay nor liquidated damages under the ADEA compensates the victim of age discrimination for the traditional personal harms associated "with personal injury, such as pain and suffer-

¹⁴ The Tax Court similarly erred in relying (Pet. App. 29a) on a statement contained in unrelated legislative history involving 1978 amendments to the ADEA that, also evidently relying on the inapposite decisions of *Brooklyn Savings Bank* and *Overnight Motor Transportation*, contained the same misdescription of the nature of liquidated damages under the ADEA. This Court's 1985 decision in *Trans World Airlines, Inc. v. Thurston*, which plainly held (and clearly explained) that ADEA liquidated damages are an enforcement mechanism that is punitive in nature, should have laid to rest the anachronistic error of relying on *Brooklyn Savings Bank* and *Overnight Motor Transportation* for any contrary conclusion.

ing, emotional distress, harm to reputation, [and] other consequential damages" (*United States v. Burke*, 112 S. Ct. at 1873), the recovery of such payments does not represent damages received "on account of personal injuries" and is not excluded from income under Section 104(a)(2).¹⁵

C. Liquidated Damages Under The ADEA Are Not Excluded From Income Under Section 104(a)(2) For The Additional Reason That They Are Awarded "On Account Of" The Defendant's Willful Misconduct Rather Than "On Account Of" The Taxpayer's Personal Injury

The conclusion that ADEA back pay and liquidated damages are not excluded from income by Section 104(a)(2) follows directly from this Court's decisions in *United States v. Burke* and *Trans World Airlines, Inc. v. Thurston*. There is, moreover, an additional and independent reason why respondent's

¹⁵ The Ninth Circuit speculated that "ADEA liquidated damages might compensate some plaintiffs for the emotional distress and future psychic injuries they may suffer upon return to work, for lost future wages which they cannot mitigate, for lost reputation, for their families' emotional distress and suffering, for the psychic toll of suing one's employer or any number of other injuries" (*Schmitz v. Commissioner*, 34 F.3d at 796 n.8). That speculation is entirely without support. Evidence of these types of personal injuries is inadmissible in an ADEA trial. See pages 18-19, *supra*. Moreover, the amount of the liquidated damages award, when available, is calculated wholly without consideration of the extent of such injuries. See page 20, *supra*. As this Court held in *United States v. Burke*, although such personal injuries may be presumed to exist, in varying degrees, in any employment discrimination case (112 S. Ct. at 1873), a statutory remedy that does not in fact compensate those injuries does not yield damages "on account of personal injuries" under Section 104(a)(2).

recovery of liquidated damages under the ADEA is not excluded from income under Section 104(a)(2).¹⁶

When applicable, Section 104(a)(2) permits exclusion only of damages received "on account of" personal injuries. As the Fourth Circuit concluded in *Commissioner v. Miller*, 914 F.2d 586 (1990), damages awarded as punishment of a wrongdoer, rather than as compensation for an injury, are awarded "on account of" malice or willfulness, not "on account of" personal injury. *Id.* at 589-592.¹⁷ Accord *Hawkins v. United States*, 30 F.3d 1077, 1080-1084 (9th Cir. 1994), petition for cert. pending, No. 94-1041 (filed Dec. 9, 1994); *Reese v. United States*, 24 F.3d 228,

¹⁶ This additional rationale need not be addressed by the Court if it concludes, under the reasoning of the Court's decision in *Burke*, that back pay and liquidated damages are not excluded from income under Section 104(a)(2).

¹⁷ In *Commissioner v. Miller*, the court of appeals stated that recoveries of liquidated damages under the Equal Pay Act were distinguishable from punitive damages on the theory that the statutory liquidated damages served "both a deterrent and compensatory purpose." 914 F.2d at 591. The court based that description of statutory liquidated damages solely on its decision in *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989). See 914 F.2d at 591. In turn, in *Thompson*, the court relied directly on this Court's decision in *Brooklyn Savings Bank* for the conclusion that liquidated damages under the Equal Pay Act represent "compensation" of the employee rather than punishment of the employer. 866 F.2d at 712. That reliance on *Brooklyn Savings Bank* was in error for the reasons explained on pages 20-24, *supra*. Liquidated damages under the Equal Pay Act, like the FLSA (after 1947), are not compensatory; they are available as a deterrence to those employers who do not act in "good faith." 29 U.S.C. 260. See *Trans World Airlines, Inc. v. Thurston*, 469 U.S. at 128 n.22.

230-235 (Fed. Cir. 1994). Punitive damages and statutory penalties for "willful" violations of the law thus do not come within the literal terms of the exclusion from income provided by Section 104(a)(2).¹⁸

1. As the court of appeals explained in *Reese v. United States*, 24 F.3d at 230, "[t]he language 'on account of' is not free of ambiguity; rather, it is susceptible of at least two conflicting interpretations."

Under a but-for causation approach, the fact that a plaintiff has to sustain a personal injury as a prerequisite to an award of punitive damages leads to the conclusion that the punitive

¹⁸ The only conflicting appellate authority is *Horton v. Commissioner*, 33 F.3d 625, 631-632 (6th Cir. 1994). In that case, the Sixth Circuit stated that it disagreed with the conclusion in *Commissioner v. Miller*, *supra*, and *Hawkins v. United States*, *supra*, that punitive damages were not excluded from income under Section 104(a)(2). The court reasoned, however, that, under Kentucky law, the taxpayer's award of punitive damages "served a compensatory function," as well as a punitive purpose, and stated that the *Miller* and *Hawkins* decisions were "distinguishable" on that basis. 33 F.3d at 631-632.

The Ninth Circuit once held that punitive damages were excluded from income under the statute, but did so in reliance on a 1975 Revenue Ruling that had abandoned the Treasury's prior, longstanding position that punitive damages were not excluded from income under Section 104(a)(2). See *Commissioner v. Miller*, 914 F.2d at 591, citing *Roemer v. Commissioner*, 716 F.2d 693, 700 (9th Cir. 1983). After the Treasury returned to its original view, and ruled again in 1984 that punitive damages are not excluded from income, the Ninth Circuit rejected its decision in *Roemer* and interpreted the statute not to exclude punitive damages from income. *Hawkins v. United States*, 30 F.3d at 1082. See Rev. Rul. 85-98, 1985-2 C.B. 51; Rev. Rul. 84-108, 1984-2 C.B. 32; Rev. Rul. 75-45, 1975-1 C.B. 47.

damages were "on account of" the plaintiff's injury, even though a punitive damage award requires the additional showing of, and is responsive only to, egregious conduct by the defendant. However, under a sufficient causation approach, the fact that personal injury is a prerequisite to punitive damages does *not* lead to the conclusion that the punitive damages were "on account of" the plaintiff's injuries because, even if the other elements of the tort are present, personal injury alone does not sustain a punitive damage award. The fact that a plaintiff seeking punitive damages has to show egregious conduct by the defendant indicates that the plaintiff's injury was not a sufficient cause of the punitive damages. Thus, the mere fact that "on account of" suggests "causation" does not answer the question of whether "on account of" suggests but-for causation or sufficient causation.

Commissioner v. Miller, 914 F.2d at 589-590 (footnote omitted). Accord *Reese v. United States*, 24 F.3d at 230-231.

Based upon the "well-recognized, even venerable, principle that exclusions to income are to be construed narrowly," these courts correctly resolved the textual ambiguity in favor of a narrow construction of the statutory exclusion from income. *Commissioner v. Miller*, 914 F.2d at 590, citing *Commissioner v. Jacobson*, 336 U.S. 28, 49 (1949). See also *Hawkins v. United States*, 30 F.3d at 1084, citing *United States v. Centennial Savings Bank*, 499 U.S. at 583-584. They therefore concluded that punitive damage awards are not excluded from income under Section 104(a)(2) because those awards are obtained "on account of" the defendant's malice or willfulness rather than "on account of" the personal injuries of the taxpayer.

2. This interpretation of the text of the statute comports with its structure, its legislative history and its evident purpose. As the title of the statute reflects, Section 104(a)(2) provides an exclusion from income for "[c]ompensation for injuries or sickness," not for sanctions awarded to deter malicious or willful misconduct.¹⁹ The Federal Circuit correctly observed in *Reese v. United States*, 24 F.3d at 231, that the focus of the statute in general, and of each of its subsections in particular,²⁰ is on amounts that compensate for injury or sickness, not on payments exacted to punish misconduct. Accord *Hawkins v. United States*, 30 F.3d at 1083. Cf. *United States v. Burke*, 112 S. Ct. at 1876 (Scalia, J., concurring).

"There is also evidence in the legislative history of section 104(a)(2) supporting the conclusion that

¹⁹ In *INS v. National Center for Immigrants' Rights, Inc.*, 112 S. Ct. 551 (1991), the Court noted that "the title of a statute or section can aid in resolving an ambiguity in the legislation's text." *Id.* at 556, citing, e.g., *Mead Corp. v. Tilley*, 490 U.S. 714, 723 (1989).

²⁰ Section 104(a)(1) excludes from gross income "amounts received under workmen's compensation acts as compensation for personal injuries or sickness." Section 104(a)(3) excludes certain "amounts received through accident or health insurance for personal injuries or sickness * * *." Section 104(a)(4) excludes "amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service * * *." Section 104(a)(5) excludes "amounts received by an individual as disability income attributable to injuries incurred as a direct result of a * * * terrorist attack * * * while such individual was an employee of the United States engaged in the performance of his official duties outside the United States." See 26 U.S.C. 104(a)(1)-(5).

punitive damages are not excludable from gross income." *Reese v. United States*, 24 F.3d at 232. Just prior to the enactment of the original version of Section 104(a)(2) as Section 213(b)(6) of the Revenue Act of 1918 (see note 3, *supra*),

the Secretary of the Treasury requested an opinion from the Attorney General concerning the tax treatment of accident insurance proceeds received on account of personal injuries. See 31 Op. Atty. Gen. 304 (1918). In response, the Attorney General concluded that "the proceeds of an accident insurance policy [were] not 'gains or profits and income'" but were instead a return of capital and hence were not taxable in accordance with statute and precedent. *Id.* at 308; accord *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918).

After the Attorney General's report, the IRS issued a decision holding that "the proceeds of an accident insurance policy received by an individual on account of personal injuries . . . [were] not taxable" T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918). Moreover, the IRS held "upon similar principles that an amount received by an individual as the result of a suit or compromise for personal injuries" would not be taxable. *Id.*

Subsequent to these events, section 213(b)(6) was enacted. In a 1918 report of the House Committee on Ways and Means, Congress explained the rationale behind section 213(b)(6) as follows:

Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages re-

ceived on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.

H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918). With the passage of section 213(b)(6), Congress likely intended to codify the IRS's stated approach, which was in turn based on the Attorney General's opinion. After the enactment of section 213(b)(6), the IRS noted that "so far as personal injuries are concerned, [section 213(b)(6)] is merely declarative of the [Attorney General's and IRS's] conclusions and intended to go no further." 2 C.B. 71, 72 (1920) (citing 31 Op. Atty. Gen. 304 and T.D. 2747). The IRS continued: "These conclusions rest, as stated, upon the theory of conversion of capital assets. It would follow that personal injury not resulting in the destruction or diminution in the value of a capital asset would not be within the exemption." *Id.* at 72.

In view of the focus on the "conversion of capital assets" theory in the passage of section 104(a)(2)'s predecessor, it would be inconsistent with the legislative history to treat punitive damages as excludable from income, since punitive damages in no way resemble a *return* of capital.

Reese v. United States, 24 F.3d at 233 (parallel citations omitted).

This Court reviewed much of this same legislative and administrative history in *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). In that case, the Court concluded that punitive damages for fraud and statutory treble damages under the antitrust

laws are income subject to tax. In so holding, the Court stated (*id.* at 432 n.8) (emphasis added):

The long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages[.] * * * *Damages for personal injury are by definition compensatory only.*

As this Court thus indicated in *Glenshaw Glass*, the limitation of Section 104(a)(2) to damages that compensate for the injury—and its inapplicability to awards that punish and deter others—comports with the history and purpose of the statute, as well as with its text and structure. See *Hawkins v. United States*, 30 F.3d at 1080-1084; *Commissioner v. Miller*, 914 F.2d at 590. See also 1 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 13.1.4 (1981) (“The rationale for [Section 104(a)(2)] * * * is presumably that the recovery does not generate a gain or profit but only makes the taxpayer whole by compensation for a loss.”).²¹

3. In 1989, Section 104(a) was amended to provide that Section 104(a)(2)’s exclusion “shall not apply to any punitive damages [received] in connection with a case not involving physical injury or physical sickness.” 26 U.S.C. 104(a) (Supp. V 1993). See Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, Tit. VII, § 7641(a), 103 Stat. 2379. In

²¹ In *Starrels v. Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962), the court explained that the history and administration of this statute reveal that “[d]amages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights—because, in effect, they restore a loss to capital.”

Burke, this Court suggested that this amendment “allow[s]” the exclusion of punitive damages in physical injury cases after 1989. 112 S. Ct. at 1871 n.6. That question, however, was not presented in *Burke* and had not been addressed by the parties in that case. The Court’s statements on that issue in *Burke* were therefore dicta.²² The proper interpretation of

²² As Professor Kahn has recently demonstrated, the suggestion that the 1989 amendment allows the exclusion of punitive damages in physical injury cases after 1989 is at odds with the history and context of the amendment. Kahn, *Taxation of Punitive Damages Obtained in a Personal Injury Claim*, 65 Tax Notes 487 (1994). The 1989 amendment originated in a House bill that would have confined the statutory exclusion to damages received in cases involving physical injury or physical sickness. H.R. 3299, 101st Cong., 1st Sess. § 11641 (1989). The House report states that this bill was a reaction to then-recent decisions (prior to *Burke*) that had held damages recovered in nonphysical injury cases involving employment discrimination and injury to reputation to be excluded from gross income. H.R. Rep. No. 247, 101st Cong., 1st Sess. 1354-1355 (1989). The House bill was modified in conference to provide only that the Section 104(a)(2) exclusion “shall not apply to any punitive damages [received] in connection with a case not involving physical injury or physical sickness.” Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, Tit. VII, § 7641(a), 103 Stat. 2379. Professor Kahn notes that the Conference Committee redacted language from another version of the bill that had affirmatively provided for the exclusion of punitive damages received in physical injury cases and substituted the “double negative” phraseology contained in the 1989 amendment. 65 Tax Notes at 489-490. The amendment thus enacted by Congress precludes application of the Section 104(a)(2) exclusion to punitive damages received in nonphysical injury cases but is silent as to the taxation of punitive damages received in physical injury cases. Any interpretation of this amendment to allow the exclusion of punitive damages in physical injury cases after 1989 would

the 1989 amendment is also not at issue in the present case, which does not involve a physical injury and instead involves an unlawful discharge and an associated tax return which preceded the effective date of the 1989 amendment.

The 1989 amendment also does not indicate that punitive damages and statutory penalties were excluded from gross income under the pre-1989 version of the statute. Neither the text of the amendment nor its history supports any suggestion that Congress (either in 1989 or in 1919) believed punitive damages were properly excluded from tax under the original statute.²³ See note 22, *supra*.

At the time of the proposed amendment, several cases had recently held that § 104(a)(2) excludes damages recovered in cases involving employment discrimination and injury to reputation * * * and some had even held that punitive damages awarded in such cases are excludable. * * * That Congress elected to overrule such cases does not prove that, prior to Congress's action, the statute meant the opposite.

Hawkins v. United States, 30 F.3d at 1082. See also *Higgins v. Smith*, 308 U.S. 473, 479-480 (1940) (re-

thus be contrary to the fundamental principle of statutory construction that "[e]xemptions from taxation do not rest upon implication." *United States Trust Co. v. Helvering*, 307 U.S. 57, 60 (1939).

²³ As this Court has frequently emphasized, "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States v. Price*, 361 U.S. 304, 313 (1960). The interpretive value of an amendment to a statute is particularly dubious when, as here, the amendment was enacted long after the original provision. *Rainwater v. United States*, 356 U.S. 590, 593 (1958).

jecting claim that enactment of an amendment explicitly forbidding a deduction for losses establishes that the law was formerly otherwise).

4. Liquidated damages for "willful violations" of the ADEA, like punitive damages generally, are "not intended to compensate the injured party, but rather to punish the [party] whose wrongful action was intentional or malicious, and to deter him and others from similar extreme conduct" (*City of Newport v. Fact Concerts, Inc.*, 453 U.S. at 266-267). See *Trans World Airlines, Inc. v. Thurston*, 469 U.S. at 125. Such damages are awarded on account of the employer's willful misconduct, not as compensation for injury. They are therefore not excluded from income under Section 104(a)(2).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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